Service Date: July 28, 1987

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER Of The Montana Public Service Commission's Investigation of Federal Tax Reform Impacts on Public Utility Revenue Requirements.	)	UTILITY DIVISION DOCKET NO. 86.11.62 (9) INTERIM ORDER NO. 5283

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INTERIM RATE ORDER

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FINDINGS OF FACT

1. On November 24, 1986, the Montana Public Service Commission (MPSC or Commission) initiated this Docket with an Order to Show Cause, Order No. 5236, that existing rates for public utilities remain just and reasonable following the Tax Reform Act of 1986 (TRA). All respondents were ordered to provide the information required by the Commission's minimum filing requirements on or before February 1, 1987.

2. Accordingly, on February 2, 1987, Montana Power Company (MPC, Company, or Applicant) filed with the Commission its response and motion to dismiss in compliance with Order No. 5236. In that filing, MPC stated that the effects of the TRA did not result in a need for a decrease in the Company's electric rates and provided information to verify that position, based on the historical test period 1985. This filing utilized a 40 percent Federal tax rate,

an updated capital structure, and a 12.50 percent return on equity rate to calculate a revenue deficiency of $2,154,671. The Company made several adjustments and calculations in the same manner as was approved by the Commission in Docket No. 84.11.71, Order No. 5113b, including a Federal Energy Regulatory Commission (FERC) jurisdictional study, a coal costs adjustment, and a loads and resources study. The Company also reflected the annual revenue effect of the basic revenue steps yet to be incorporated into rates under the Commission approved Rate Moderation Plan, approved in Docket No. 84.11.71, Order No. 5113b. Based on its analysis, the Company did not request a rate increase and moved that the Show Cause Order No. 5236 be dismissed as against the Company's electric utility.

3. On March 4, 1987, the Commission issued Order No. 5236a, which was a preliminary procedural order based on the Commission's finding that preliminary comment on generic legal and policy aspects of the TRA would promote a uniform regulatory approach, while avoiding unnecessary duplication of effort. Specifically, the Commission requested comment on several issues raised by the TRA.

4. On May 27, 1987, the Commission issued Order No. 5236b, which requested the utilities to answer certain questions concerning the effects on operating results of Statement on Financial Accounting Standards 87 (Statement 87), issued by the Financial Accounting Standards Board (FASB). This request for comments from the utilities in this same TRA Docket was the result of no respondents addressing this issue in their response to Order No. 5236a.

5. Based on the Commission's analysis of the utilities' and Montana Consumer Counsel's responses to Order No. 5236a, on June 8, 1987, the Commission issued Order No. 5236c, which addressed each

issue of the TRA focused on in Order No. 5236a. In Order No. 5236c, the Commission stated that the direction given in that Order may be applied to utilities' results of operations filed in Docket No. 86.11.62 (sub 9 for MPC electric) and that such application may result in tariff changes being ordered on an interim and/or final basis.

6. Pursuant to the Commission's Order No. 5236c in Docket No. 86.11.62, the Commission submitted Data Requests to all affected public utilities operating in Montana. In particular, Data Request 19 (DR 19) asked the utilities to provide a detailed table showing the itemized effects of implementing the Commission's decisions in Order No. 5236c on the revenue requirements presented in each utility's compliance filing in this Docket.

7. In compliance to DR 19, MPC provided its response in a manner similar to the "40 Percent Tax Rate Flow Through (work-papers) Supplement" provided in the original filing of February 2, 1987. By utilizing its proposed capital structure, the last granted return on equity level of 14.25 percent, and its updated loads and resources study, the Company calculated a required Montana jurisdictional revenue increase of $5,833,725. (MPC DR 19 - Supplement, page 1 of 17)

Commission Analysis

8. Based on the its determinations in Order No. 5236c, the Commission finds that the data shown in MPC's DR 19 - Supplement reflects the proper pro forma results of Montana operations from which all adjustments in this Interim Order must be made.

9. As stated above, MPC made several adjustments in its Show Cause filing to conform with the methodologies and calculations approved in Order No. 5113b of Docket No. 84.11.71. Of those

proposed adjustments, the Commission accepts for Interim purposes, unless otherwise stated herein, MPC's proposed adjustments except for those discussed and altered below and throughout the remainder of this Interim Order. All Commission adjustments discussed below, therefore, are made to MPC's pro forma Montana jurisdictional revenues, expenses, and rate base as shown on page one of MPC DR 19 - Supplement (per the discussion in Finding of Fact No. 8 above).

Capital Structure and Cost of Capital

10. The currently authorized overall rate of return for MPC's electric utility is:

Description	Ratio	Cost	Weighted Cost
Long Term Debt	54.62%	10.33%	5.64%
Preferred Stock	8.06%	8.52%	.69%
Common Stock	37.32%	14.25%	5.32%
	100.00%		11.65%
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This rate of return was established in Order No. 5051e in Docket No. 83.9.67, which was issued August 3, 1984. The same rate of return was subsequently stipulated to by the Montana Consumer Counsel (MCC) and MPC, and was approved by the PSC in August, 1985. Assuming information upon which the PSC based its decision in Order No. 5051c was current at the date of hearing, the rate of return on common stock (ROE) has its foundation in early 1984 data. Indications suggest that the cost of equity has declined significantly since 1984:

a. During 1984, Treasury bonds and long term AAA corporate bonds yields were 30% greater than today;

b. Other major electric utilities regulated by the PSC were being granted ROE's of 13.35% to 14% and are now allowed 12.3%.

Other indications that MPC's electric ROE is too high include:

a. The current Federal Energy Regulatory Commission (FERC) benchmark ROE for 99 electric utilities is 11.3%; and

b. A survey published by a utility industry group, the Edison Electric Institute, shows average rates of ROE granted during the last of 1986 by federal, state, and local regulators to be 13.37%.

MPC's ROE is now much higher (nearly 200 basis points) than any other authorized electric ROE granted by the PSC. Although the 12.3% ROE granted MDU and PP&L electric utilities appears to be at the midpoint of the FERC benchmark (11.3%) and ROE allowances by others (13.37%), the PSC prefers, for interim purposes, to use a moderate, conservative approach. Accordingly, the PSC finds 13% to be an appropriate, reasonable interim ROE.

11. The treatment afforded MPC's interim ROE in this order differs from the approach the PSC has used in determining interim returns on equity for the past several years. The PSC usually accepts the ROE approved in the utility's most recent final order. The PSC finds, however, that a long period of time has elapsed since MPC's last authorized return was determined on the basis of the Commission's evaluation of expert witnesses' testimony. During the early 1984 to mid-1987 period, capital costs appear to have fallen substantially, and this has been affirmed in the

Commission's orders. To ignore these factors would be incorrect.

12. Although the PSC intends, for most cases, to adhere to the standard of using the most recently approved return on equity for the affected utility, extenuating circumstances may cause the Commission to deviate from this standard and moderately reflect changing circumstances in interim orders.

13. The Commission finds that reducing MPC's return on equity from 14.25% to 13.00% in this Interim Order is a moderate reduction but achieves a reasonable interim balance.

14. The Commission notes that other changes, some very significant, are presented in MPC's proposed capitalization:

	Or. 5051c, Aug. 1984		Dkt. 86.11.62, Feb. 1987	
	% of Capital	Cost	% of Capital	Cost
Long Term Debt	54.62	10.33%	49.06%	9.01%
Preferred Stock	8.06	8.52%	5.05%	7.29%
Common Stock	37.32%	14.25%	45.89%	14.25%

Although the PSC has typically allowed moderate changes in both capital structure and the cost of long term debt and preferred stock for interim purposes, the changes in the capital structure as filed are striking, particularly the change in the common stock (equity) ratio. Apparently, after the sale/leaseback of Colstrip 4, MPC retired certain long term debt issuances, which resulted in an equity rich capital structure.

15. Both MPC and the PSC have acknowledged that Colstrip 4 is nonjurisdictional. Although the PSC is sympathetic to MPC's desire to hold long term debt interest expenses to a minimum during the period in which it can not profitably market the power output of

Colstrip 4, the PSC is also very concerned that Montana retail customers not be penalized. MPC's proposed 45.89% common equity ratio is much higher than that of either PP&L or MDU's electric utility:

	Docket	Common Equity Ratio
PP&L	85.10.41	35.15%
MDU Electric	86.5.28	35.548%

It is also substantially higher than the hypothetical 40% common equity ratio recently stipulated to and approved for MPC's gas utility.

16. It is only with a great deal of trepidation that the PSC accepts, for interim purposes only, the common equity ratio presented by MPC. A change to the equity ratio last approved (37.32%) or even a midpoint between it and a 45.89% ratio, coupled with the moderate reduction in ROE, would cause a substantial decrease in revenue requirement. It is with the tenant of moderation in mind that the PSC finds that it will not order an interim adjustment to the filed equity ratio. In accepting MPC's proposed capital ratios in this Interim Order, however, the Commission emphasizes that this issue should be fully considered in the course of this proceeding.

17. The following table shows MPC's electric capital structure and costs as approved in this Interim proceeding:

Description	Amount	Ratio	Cost Rate	Weighted Cost
Long-Term Debt	$419,284	49.06%	9.01%	4.42%
Preferred Stock	43,147	5.05%	7.29%	0.37%
Common Stock	392,163	45.89%	13.00%	5.97%
Total	$854,594	100.00%		10.76%

Loads and Resources Study

18. In its initial filing of February 2, 1987, the Company stated that its loads and resources, purchase power costs, off-system sales revenues and thermal plant fuel costs had been developed in accordance with the metholology approved by the Commission in Docket No. 84.11.71, Order No. 5113b. MPC also said that the off-system sales had been priced using a four-year average for the years 1982 through 1985 and that the purchased power costs had similarly been determined using the same four-year average cost. The quantities of off-system sales had been determined as ordered by the Commission in Order No. 5113b.

19. During the Discovery Audit held at MPC's offices in Butte on April 22 and 23, 1987, the Company proposed a new loads and resources study for consideration in this proceeding. This new study attempts to update certain portions of the study based on MPC's analysis of current market and operational conditions and the use of the more current four-year period 1983 through 1986 for the pricing of off-system sales and purchased power costs.

20. It is very important to note that the Company's Supplemental response to DR 19, which, as stated above, is relied upon by

the Commission as MPC's pro forma Montana results of operations, includes the effects of this proposed, updated loads and resources study.

21. The Commission understands MPC's desire to present an updated loads and resources study in this proceeding so that the most current conditions can be reflected in its test year results of operations. Because of all the various proposed changes in this updated loads and resources study, however, the Commission believes that it would be improper to approve the new study on an interim basis before all intervenors had a chance to testify as to the merits of the updated study. Nonetheless, as a conservative, yet moderate, approach, the Commission finds that it is proper to use one aspect of the updated study - the more recent four-year pricing average (1983 through 1986) to be applied against the data in the original study found in the Company's initial filing. The Commission, therefore, rejects the updated loads and resources study and finds the original study to be proper in this Interim proceeding, with the exception of the use the more current four-year average for the pricing of off-system sales and purchased power costs. The results of these adjustments are a net increase in operating revenues of $8,831,000 and a net increase in purchased power costs of $7,282,000 to MPC's pro forma levels shown on the Company's Supplemental response to DR 19.

Rate Moderation Plan Adjustment

22. MPC's February filing and its responses to data requests issued in conjunction with Order No. 5236c included an adjustment to reflect the effect of tax rate changes on the rate moderation plan. Uncollected accruals prior to January 1, 1987 will include federal income taxes at 46% while 1987 will include federal income taxes at 40%. For amounts actually collected from customers over the period August 29, 1987 through December 31, 1987, taxes will be remitted to the federal government at 40%, and for amounts collected from January 1, 1988 through August 28, 1991 taxes will be paid at 34%. MPC's adjustment included accrued balances up to and including December 31, 1986.

23. For interim purposes, the PSC finds the adjustment to be proper. However, if amounts accrued but not collected during 1987 are not included, a mismatch will occur. This result is achieved because 1987 amounts accrued using a 40% federal tax rate will be collected from customers on or before August 28, 1991. MPC will actually pay the federal government 34% on these amounts. To correct this deficiency the PSC finds accrued balances up to and including December 31, 1987, are properly includable and amortized over a five-year time frame as approved in Order No. 5236c. The effect of this change further reduces revenue requirement in this Interim Order by $700,000.

Revenue Requirement

24. Based on the above Findings of Fact, the following table shows that a reduction in MPC's annual electric revenues in the amount of $4,017,000 is necessary in order to provide the opportunity to earn an overall rate of return of 10.76 percent:

MONTANA POWER COMPANY -- Docket No. 86.11.62(9)
INTERIM Revenue Requirements Chart
To Produce 10.76% Rate of Return
Test Year: December 31, 1985

(000)

	Revised MPC MT Jurisdic Pro Forma	Total Accepted Adjustments	Accepted Pro Forma	Increase For 10.76% Return	Approved Total
Operating Revenue	$316,221	$9,531	$325,752	($4,017)	$321,735
Operating Revenue Deductions					
Total O&M Expenses	$140,430	$7,282	$147,712		$147,712
Depreciation and Amortization	27,255	0	27,255		27,255
Taxes Other Than Income	29,023	2	29,025	($10)	29,015
Corporate Environmental Tax	81	2	83	(4)	79
State Income Taxes	2,537	151	2,688	(270)	2,418
Federal Income Taxes	15,610	712	16,322	(1,269)	15,053
Deferred Income Taxes	12,347	0	12,347		12,347
Total Operating Revenue Deductions	$227,283	$8,149	$235,432	($1,553)	$233,879
Net Income	$88,938	$1,382	$90,320	($2,464)	$87,856

Average Rate Base	$816,509	$0	$816,509		$816,509
Rate of Return	10.89%		11.06%		10.76%

Other Matters

25. MPC, by verbal request, seeks to account for TRA changes for actual calendar year 1987 in a manner consistent with the PSC's generic TRA Order No. 5236c. While Order No. 5236c does not portend to dictate or achieve any particular actual operating result for 1987, the Commission finds no reason why MPC's 1987 books and records should not comport with Order No. 5236c. To allow this accounting could very well aid readers of MPC's financial statements in making more consistent comparisons of 1987 data with that of later years.

26. Accordingly, the PSC shall allow such accounting for MPC as discussed in the above Finding of Fact. All future MPC rate filings must separately depict the effects of the accounting in order that they be appropriately dealt with at the time.

27. Recent staff audit activity at MPC headquarters detected recommendations that MPC align itself with other electric utilities so that it would be able to more efficiently transact wholesale and/or wholesale/retail power operations. The PSC is unsure at this time of the ramifications of these potential actions. Unanswered data requests may add clarity. Because of the uncertainty, the PSC finds that MPC shall maintain accounting records that will permit ready isolation of all costs attributable to such potential alignment.

28. Recent staff audit activity detected the presence of overpayments made by MPC to BPA for rental of Townsend/Garrison transmission facilities. Pursuant to an audit performed by the Colstrip owners, the charge was found to be excessive

by about $1.0 million per year. This change along with other arrangements with BPA have been prospectively reflected in MPC's filing. However, during April 1986 MPC received a refund, including interest, for overpayments made for the 21-month period of October 9, 1983 through June, 1985. The amount of the refund likely exceeds $1.75 million. The Commission finds that arguments likely exist that the nonColstrip 4 portion of this refund should revert to ratepayers, since the original rental payment may have been reflected in rates. However, in order to avoid prejudging the issue, the PSC requests that the issue be examined in the future.

29. The PSC notes that the Heart Mountain system has been removed from rate base in MPC's filing. While not ruling on the propriety of its removal, the PSC also is aware that the FERC has issued an order approving the transfer of these properties to Glacier Gas Company, a FERC regulated subsidiary of MPC. The PSC additionally finds that the Heart Mountain system removal, as reflected in MPC's filing in this proceeding, is not annualized. Arguments likely exist to support such annualization, if indeed its removal is warranted at all. However, to avoid prejudging this issue, the Commission requests that it be addressed in the future.

30. To aid in the goal of rate stability, the PSC finds that revenue changes found appropriate in this order will take effect on the same date as rate changes arising from the rate moderation plan filed July 16, l987. Since about one month will pass between the effective date of this action and the rate moderation plan action, MPC is directed to account for the difference from presently effective tariffs for that time period, apply interest at half (1/2) the ROE rate of 13% on

the total balance at the time tariffs are changed, and amortize the balance over one year.

31. In conformance with Order No.5236 in this Docket, dated November 24, 1986, the Commission finds that the revenue reduction for MPC precipitated by this Interim Order shall be spread to all classes of customers, excluding special rates classes (EIRI and EEI), on an equal percentage basis. The special rates classes of customers are excluded from this revenue decrease because of the highly questionable level of contribution to the payment of MPC's income taxes that these classes of customers have been making and will continue to make as long as their rates are somewhat discounted from the full retail rate level as the result of being market-driven rather than cost- based rates.

32. Accompanying MPC's initial filing in this Docket was a motion to dismiss the Company from the Show Cause Order in this proceeding. Based on its findings in this Interim Order, the Commission denies the Company's motion to dismiss for the purposes of this Interim Order.

33. The Commission determines that the Company's filing in this Docket is complete.

CONCLUSIONS OF LAW

1. The Applicant, Montana Power Company, furnishes electric service to Montana consumers, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. Title 69, Chapter 3, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

3. Section 69-3-304, MCA, provides in part... "The Commission may, in its discretion, temporarily approve increases or decreases pending a hearing or final decision."

4. The rate levels and spread approved herein are a reasonable means of providing this interim annual revenue reduction for Montana Power Company.

5. The Commission finds that the Company's filing in this Docket, as modified by this Order, complies with the Commission's Interim rules. ARM 38.5.501 et seq.

ORDER

THEREFORE THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Applicant, Montana Power Company, is hereby ordered to implement on an interim basis decreased rates designed to reduce annual electric revenues by $4,017,000.

2. Montana Power Company is to file revised rate schedules pursuant to Finding of Fact Nos. 30 and 31.

3. Rate schedules filed shall comport with all Commission determinations set forth in this Interim Order.

4. Nothing in this Interim Order precludes the Commission from adopting in its Final Order, after reviewing the entire record in this Docket, a revenue requirement different from that contained in this Interim Order.

5. The interim annual revenue reduction granted in this Interim Order is to be effective for electric service rendered on and after August 1, 1987, and in compliance with Finding of Fact Nos. 30 and 31.

DONE IN OPEN SESSION at Helena, Montana, this 27th day of July, 1987, by a 4 - 1 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

JOHN B. DRISCOLL, Commissioner

ATTEST:

Ann Purcell
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.